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Enhanced Long Distance, Residential Voice Mail
6 Optimum Voice Mail, Nationwide Voice Mail,
7 United Voice Messaging, and Nationwide Voice
Messaging

UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

1 Plaintiffs, Enhanced Long Distance, Residential Voice Mail Optimum Voice Mail,
 2 Nationwide Voice Mail, United Voice Messaging, and Nationwide Voice Messaging [hereinafter
 3 cited as "Plaintiffs"], move for a temporary restraining order and preliminary injunction requiring
 4 Debtor, The Billing Resource, dba Integretel, Inc.[hereinafter cited as "TBR", "IGT" or "Debtor"], to
 5 refrain from using the funds which are held in trust for the benefit of Plaintiffs for any purpose,
 6 and to segregate said funds into a separate account.
 7

8 **I.**

9 **PLAINTIFFS FUNDS ARE HELD IN TRUST BY DEBTOR, AND THUS ARE NOT PART**
 10 **OF THE BANKRUPTCY ESTATE OF DEBTOR**

11
 12 Plaintiffs' each entered into a Master Services Agreement [hereinafter cited as "MSA"]
 13 with the Debtor after mid-summer of 2002¹. In 2002, another billing and collections company,
 14 OAN, filed bankruptcy. OAN, much as Debtor has, claimed that the Billing Transactions
 15 submitted for collection by OAN's customers, were accounts receivable of OAN. Troubled by
 16 this possibility, Plaintiffs, as they entered into MSAs with Debtor negotiated for specialized
 17 treatment of all funds which could lead to payment of funds owed to Plaintiffs. Declaration of
 18 Jordan, Borstein, and Liquorish. The contracts under which Debtor conducts business with the
 19 Plaintiffs all contain special language controlling the handling of all receivables that may give
 20
 21
 22
 23

24 _____
 25 ¹Residential Voice Mail, Inc., [hereinafter cited as "RVM"] entered into its MSA on February
 26 4, 2004. Enhanced Long Distance, Inc., [hereinafter cited as "ELD"] entered into its MSA on
 27 October 1, 2004. Optimum Voice Mail, Inc., [hereinafter cited as "OVM"] entered into the
 28 MSA with Debtor on January 1, 2005. Nationwide Voice Mail, Inc. [hereinafter cited as
 "NVM] contracted with Debtor on December 5, 2002. Nationwide Voice Messaging, Inc.,
 [hereinafter cited as "NVMI"] entered into it's MSA on May, 1 2003. United Voice Messaging,
 Inc., entered into contract with Debtor on July 1, 2003. True and correct copies of the contracts
 are attached to the declarations of Ms. Liquorish, Mr. Borstein, and Ms. Jordan.

1 rise to Net Proceeds due to Plaintiffs generated by the processing of the Billing Transactions²
 2 processed by Debtor.
 3

4 All Net Proceeds arising from Client's Billing Transactions, as such terms are defined
 5 hereunder, are, and shall remain at all times, the property of Client and IGT may not use
 6 any such Net Proceeds for any purpose other than to offset or satisfy obligations rightfully
 7 due to IGT hereunder. IGT acknowledges that all receivables that may give rise to Net
 8 Proceeds due to Client are beneficially the property of Client even though such
 9 receivables may be in IGT's name or possession.

10 Paragraph 7 – Schedule II – PhoneBill SERVICES (TELCO BILLING)

11 The negotiated language creates a trust. This Court should require Debtor to segregate the funds,
 12 because the funds are not property of the bankruptcy estate.

13 **A. THE FUNDS COVERED BY PARAGRAPH 7 ARE NOT PROPERTY OF**
THE BANKRUPTCY ESTATE.

14 The Bankruptcy Code specifies that funds held in trust do not become property of the
 15 bankruptcy estate.

16 (a) The commencement of a case under section 301, 302, or 303 of this title creates an
 17 estate. Such estate is comprised of all the following property, wherever located and by
 18 whomever held: (1) Except as provided in subsections (b) and (c)(2) of this section, all
 19 legal or equitable interests of the debtor in property as of the commencement of the case.
 ... (c)(2) A restriction on the transfer of a beneficial interest of the debtor in a trust that is
 enforceable under applicable nonbankruptcy law is enforceable in a case under this title.

20 11 U.S.C. Section 541(c)(2).

21 Funds are held in an express trust when the settlor manifests an intent to create a trust, designates
 22 trust property, identifies a beneficiary, and does so for a lawful purpose. Cal. Probate Code
 23 Sections 17500 - 17505.

24 ///

25
 26
 27 ²Billing Transactions is a defined term in each MSA referring to the data records which Debtor
 28 processes.

1 [a] trust may be created by any of the following methods: (a) A declaration by the owner
 2 of property that the owner holds the property as trustee.(b) A transfer of property by the
 3 owner during the owner's lifetime to another person as trustee. ... (e) An enforceable
 promise to create a trust.

4 West's Ann.Cal.Prob.Code Section 17500³.

5 It is black letter law in the State of California that the action of placing property in the custody of
 6 another to be held solely for the benefit of the person so placing it creates an express trust,
 7 whether the language states so, or not, so long as the intent is clear.

8 When one expresses the intention to hold the legal title but that another should have the
 9 beneficial interest, the implication necessarily follows that the former intended to create a
 10 trust of defendant and that the legal title was left in the latter that he might vote the stock
 11 and manage and dispose of the property with greater facility and advantage. ... It is well
 12 settled that no set form of words is necessary to create a trust. Nor need the word "trust"
 13 or "trustee" be used. (*Luco v. De Toro*, 91 Cal. 405, [18 Pac. 866, 27 Pac. 1082]; *Booth v.*
Oakland Bank of Savings, 122 Cal. 19, [54 Pac. 370].)

14 Taber v. Bailey, 22 Cal.App. 617, 620 (Cal.App.3.Dist.1913)

15 In Elliot v. Bumb, 356 F.2d 749 (9th Cir. 1996), the ninth circuit addressed the question of
 16 whether contracts placed for collection with another entity pursuant to a written agreement
 17 stating that the funds were held in trust for the benefit of the depositors, created an express trust,
 18 at the time that the funds came into possession of the Debtor.

19 As to the identifiable sum of \$2,014.99, the District Court made the correct determination in
 20 favor of Security's trustee. Although one may become bankrupt, property which is held by
 21 him in trust belongs to the beneficiary of the trust. 4 Collier, Bankruptcy P70.25(2) (14th ed.
 22 1964) (hereinafter called Collier); 3 Remington, Bankruptcy § 1212 (Henderson ed. 1957).
 23 Apart from the provisions of the California Financial Code, the segregated amount is corpus
 24 of a trust. The bankrupts' written agreement was a valid trust agreement under California law.
 25 See Cal.Civ.Code §§ 2221, 2222. While no trust corpus existed as of the time of the
 26 agreement, it has been held, in equity, that if parties intend to create a trust at a future time
 27 when the corpus comes into being, the trust should take effect at such future time and the

28 ³Probate Code Section 17200 et seq. encompass former Civil Code Sections 2221, and 2222.

equitable interest pass to the beneficiary. *I Bogert, Trusts and Trustees* § 113, pp. 575-76 (2d ed. 1965). Generally, the question of whether a trust is established is one to be resolved by the application of state law. See Jaffke v. Dunham, 352 U.S. 280, 281, 77 S.Ct. 307, 1 L.Ed.2d 314, (1957). Although no California court has ruled directly upon the question in a cause involving such an explicit trust agreement as that made by the bankrupts here, the California Supreme Court has written, 'A mere promise to obtain money and thereupon hold it in trust does not create a trust until it is at least so far executed that the money has been obtained in accordance with the promise.' Molera v. Cooper, 173 Cal. 259, 262, 160 P. 231 (1916). See also 89 C.J.S. Trusts § 24, p. 741, and § 151, pp. 1064, 1068 (1955); Restatement (Second), Trusts § 30 (1959). From the quoted language, it must be inferred that California courts would hold, under the terms of the explicit agreement here, that a trust actually came to be established upon the receipt of those corpus funds which were so clearly anticipated in the agreement precisely defining their trust quality and manner of handling. Furthermore, even had there been no written agreement, the relationship of Security and Van's as principal and agent would seem to have required the impressing of a constructive trust upon funds received by the agent from the sale of his principal's property and retained by the agent in segregated identity. See Rodes v. Shannon, 222 Cal.App.2d 721, 725, 35 Cal.Rptr. 339 (1963); Spector v. Miller, 199 Cal.App.2d 87, 95, 18 Cal.Rptr. 426 (1962); Darrow v. Robert A. Klein & Co., 111 Cal.App. 310, 295 P. 566 (1931); Cal.Civ.Code § 2322. Therefore, as to the \$2,014.99, in existence and clearly identified, the trustee of Security's estate is entitled to the fund.

Elliott v. Bumb 356 F.2d 749, 753 -754 (9th Cir. 1966)

16 Elliot, and its progeny, make clear that personal property deposited with another for collection
17 becomes a valid trust at the time the funds come into the possession of the debtor, so long as
18 there is a statement of intent demonstrating the intent to hold the funds in trust at the time of
19 creation of the collection agreement. See also California-Nevada Annual Conference of United
20 Methodist Church v. St. Luke's United Methodist Church, 121 Cal.App.4th 754, 767 (2004).
21

23 The language in this contract is express. The wording makes clear that Plaintiffs retain
24 ownership rights in the funds at all times that the funds are in the possession of Debtor.

25 All Net Proceeds arising from Client's Billing Transactions, as such terms are defined
26 hereunder, are, and shall remain at all times, the property of Client ...

1 Furthermore, the second clause of the paragraph further restricts Debtor's use of the funds, such
 2 that Debtor may not use any funds which might be end up as Net Proceeds" for anything other
 3 than the benefit of Plaintiffs.
 4

5 [A]nd IGT may not use any such Net Proceeds for any purpose other than to offset or
 6 satisfy obligations rightfully due to IGT hereunder.
 7

8 Paragraph 7, MSA supra.
 9

10 The last clause of the paragraph then expressly states both the intent that the agreement create a
 11 trust, identifies the funds which are the res of the trust, and identifies the beneficiary of the trust.
 12

13 IGT acknowledges that all receivables that may give rise to Net Proceeds due to Client
 14 are beneficially the property of Client even though such receivables may be in IGT's
 15 name or possession.
 16

17 Paragraph 7, MSA supra.
 18

19 All Net Proceeds, as well as all funds which may give rise to Net Proceeds are, pursuant to
 20 California law, held in trust by TBR, for the benefit of all six Plaintiffs. Pursuant to 11 U.S.C.
 21 Section 541, such trust funds are not part of the bankruptcy estate. This Court should, at a
 22 minimum require Debtor to segregate those funds, to prohibit the funds from being used for non-
 23 trust purposes.
 24

25 **B. DEBTOR'S REPORTS ALLOW THIS COURT, AND THE PLAINTIFFS' TO**
TRACE THE FUNDS OWED TO PLAINTIFFS TO DEBTOR'S MASTER
ACCOUNT.

26 In general, bankruptcy law requires that a party who tries to impress a constructive trust
 27 on funds held by a Debtor must meet a strict tracing standard. See, Begier v. IRS, 496 U.S. 53,
 28

1 62-62. (1990). However, strict tracing standards do not apply where there is an express trust
 2 agreement.
 3

4 However, unlike the cases cited by Kupetz, the present case involves an express trust
 5 relationship regarding funds kept in a discrete trust account. The tracing requirement
 6 discussed above only pertains to situations in which the would-be beneficiary seeks to
 7 impress a constructive trust upon currently commingled property of the debtor. *See Collier on*
8 Bankruptcy, ¶ 541.13, at 541-77 to 541-79. There is no precedent supporting the proposition
 9 that restored express trust funds are also subject to this requirement, and we do not believe
 10 that Kupetz's argument is consistent with applicable principles of bankruptcy law.^{FN8} As
 11 noted earlier, under California law, restorative payments to a trust account serve to
 12 reconstitute a depleted trust fund. Thus, once CTTS deposited funds into the FIB trust
 13 account by way of restitution, the restored funds became valid trust funds that were no longer
 14 the property of CTTS and, therefore, no longer subject to the tracing requirement.
 15

16 In re California Trade Technical Schools, Inc. 923 F.2d 641, 647 (9th Cir.,1991)
 17 Plaintiffs' declarations trace the Billing Transactions deposited with the Debtor, through
 18 testimony about the reports issued by Debtor's employees to the Plaintiffs' agent, Mr. Nelson
 19 Gross. See Declaration of Ms. Liquorish, Ms. Jordan and Mr. Bornstein. Those reports,
 20 produced by the Debtor, identified the amounts held in trust, for the benefit of Plaintiffs' as of
 21 the time that Debtor filed Chapter 11. Debtor holds the following amount in trust for Plaintiffs:
 22 OVM \$572,638.94, RVM \$831,862.16, UVMI \$763,852.69, NVM \$676,157.06, UVM
 23 \$117,610.72, NVMI \$907,337.22 and ELD \$1,048,151.67. Pursuant to In Re California Trade
 24 Technical Schools, Inc., Plaintiffs are only required to trace the funds into Debtor's accounts so
 25 long as the total amount due and owing is not more than the amount held by Debtor in its
 26 accounts. The total amount owed to all Plaintiffs is \$5,017,664.24 (five million, seventeen
 27 thousand, six hundred sixty four dollars and twenty four cents). The total amount of unrestricted
 28 funds shown on the most recently filed monthly operating report is \$8,134,394 (eight million,
 29

1 one hundred thirty four thousand, three hundred ninety four dollars), well above the amount
 2 owed to Plaintiffs.
 3

4 **II.**

5 **THIS COURT SHOULD ORDER DEBTOR TO TREAT THE FUNDS AS SEGREGATED**
TRUST FUNDS TO INSURE THAT DEBTOR DOES NOT DISSIPATE THE FUNDS,
THUS RENDERING THEM UNAVAILABLE EITHER THROUGH OPERATION OF THE
BANKRUPT ESTATE, OR THROUGH USE OF THE ASSETS TO FUND ITS PROPOSED
PLAN OF REORGANIZATION.

6
 7 The language of Paragraph 7 requires Debtor to treat the funds which may give rise to
 8 Net Proceeds, as separate, segregated property. Plaintiffs are requesting this Court order the
 9 Debtor to do so.

10
 11 Plaintiffs face irreparable harm if Debtor fails to follow its fiduciary obligation as to the
 12 trust funds. The irreparable harm falls into two categories. First, the risk that through operations
 13 of the business while in the Chapter 11 proceeding, Debtor will reduce the available funds below
 14 the amount which is required to be held in trust, therefore rendering Plaintiffs' without an ability
 15 to recover their property. Second, Debtor's plan will create a payment scheme which will
 16 remove the funds from the control of the Debtor, such that they will be rendered unavailable to
 17 their beneficial owner: Plaintiffs.

18
 19 **A. DEBTOR'S OPERATIONS CREATE A SIGNIFICANT RISK THAT DEBTOR**
WILL USE THE FUNDS HELD IN TRUST IN ITS OPERATIONS AND
RENDER PLAINTIFFS' UNABLE TO RECOVER.

20
 21 Debtor is currently operating at a loss. The continuing lack of gross revenues, combined
 22 with Debtor's profligate administrative expense spending renders it likely that Debtor will use up
 23

1 the funds which Debtor is required to hold in trust for Plaintiffs. Once those funds are spent,
 2 Plaintiffs have no route for recovery, as the funds are held in trust, and are not secured.
 3

4 Debtor's filings about its financial status make the depth of the problem clear. First,
 5 Debtor's is currently operating at a loss. Debtor's most recent monthly operating report
 6 [hereinafter cited as "MOR"] identifies gross sales as \$1,048,353. That same MOR identifies
 7 gross profit as \$190,193. This comports with the reports received by Plaintiff's counsel, which
 8 reflect the gross deposits, which demonstrate numbers between \$1,000,000 per month and
 9 \$1,600,000 per month. Debtor collects approximately 10% revenue from the gross deposits,
 10 attributable to the fees it generates in the processing of the Billing Deposits. Deposits of
 11 \$1,000,000 thus generate approximately \$100,000 in profit per month. See Declaration of
 12 Kathryn S. Diemer. Debtor's last MOR indicates that Debtor spent \$612,048 on professional
 13 fees. In essence, Debtor spent \$421,855 more on its professional fees during November, 2007
 14 than it earned in gross profit during that same month.⁴ Review of the Statement of Operations
 15 demonstrates that for the last reporting period, not including any sales returns and allowances,
 16 Debtor lost \$657,585.
 17

18 Last month was not an anomaly. Debtor lost \$784,465 the previous month, again not
 19 including any sales returns and allowances. The Debtor filed bankruptcy on September 16,
 20 2007. In the last 3 months Debtor has lost almost two million dollars, again not taking into
 21 account any allowances for problematic traffic.⁵

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⁴See line 5, Statement of Operations for 11/1/07 through 11/30/07, and compare it to line 37 on
 the same page.

⁵Debtor's failure to identify any sum due and owing for potential returns and allowances is
 (continued...)

1 Debtor currently holds \$8,134,394 (eight million, one hundred thirty four thousand, three
 2 hundred and ninety four dollars) in its unrestricted funds. Debtor holds \$5,017,664.24 (five
 3 million, seventeen thousand, six hundred sixty four dollars and twenty four cents) in trust for the
 4 benefit of Plaintiffs under the terms of the MSAs. That leaves a balance of \$3,116,730.

6 Debtor stipulates that POL, Inc. is a secured creditor holding a contingent claim in the
 7 amount of approximately \$1,000,000. The majority of secured funds owed are contingent on a
 8 settlement with the New York State Taxing Authority. Within the last month, Debtor has
 9 entered into a settlement agreement with the New York State Taxing Authority, which removes
 10 the contingent nature of claim as to approximately \$870,671. Deducting this additional
 11 amount from the funds held by Debtor, leaves a balance of unrestricted funds in the
 12 amount of \$2,246,059.

15
 16 Debtor has also stipulated to a secured claim in favor of Payment One, a virtually
 17 wholly owned subsidiary of the Debtor. Payment One claims a security position in
 18 excess of \$16,616,000. There is some dispute as to whether Payment One's security
 19 position is subject to a significant offset for preferential transfer. However, Debtor has
 20 entered into a stipulation with Payment One as to a portion of that secured debt on the
 21 theory that Payment One has a significant defense in the form of new value and/or
 22 contemporaneous exchange. Based upon that defense, Debtor has, throughout the case
 23
 24

26 _____
 27 ⁵(...continued)
 28 worrisome given that both the LEC's and the customers have the right to demand such
 allowances depending on activities within the billing.

1 to date, held out Payment One as a secured creditor. Payment One and Debtor allege the
 2 amount of the new value allowances at \$6,400,000. Both of the amounts alleged by
 3 Payment One are significantly in excess of the amount which is currently identified as
 4 unrestricted funds in the custody of Debtor. If Payment One were to successfully
 5 exercise its rights as a secured creditor and require adequate protection payments, or
 6 were to move for relief from stay, or otherwise exercise its secured creditor rights,
 7 significant risk exists that no unrestricted funds would exist to repay Plaintiffs the sums
 8 they are owed.

12 Plaintiffs expect Debtor to argue that it has sufficient operating capital to insure
 13 that Plaintiffs trust funds will be paid when processing is complete. If this Court ignores
 14 the rights of the secured creditors, Debtor may well have sufficient funds to operate for a
 15 brief period. Given that Debtor lost \$1,802,143 during the 2 ½ months from filing
 16 through the date of the last filed MOR, there is significant reason to believe that the
 17 Debtor might well extinguish the cushion for the trust funds simply by operating the
 18 business for the next few months. Once Debtor dips below the amount that is owed to
 19 Plaintiffs, Plaintiffs lose their ability to recover the funds which they own, but which
 20 Debtor controls, without recourse. This Court should find that irremediable harm exists
 21 to avoid Plaintiffs property, which is not property of the bankruptcy estate being
 22 squandered.

1 **B. DEBTOR'S PLAN OF REORGANIZATION RISKS LOSS OF THE**
 2 **TRUST FUNDS, AND CONVERTS THEIR NATURE FROM TRUST**
 3 **FUNDS TO ORDINARY INCOME.**

4

5 Debtor treats Plaintiff's claims as general unsecured claims in its plan. Debtor's
 6 plan does not purport to be a 100% payout plan. Instead the plan depends on a white
 7 knight to buy the company. There is no one currently identified as a stalking horse
 8 bidder. Nor is there any evidence that sufficient funds will be generated by the proposed
 9 sale to allow 100% payout of the unsecured creditors. Without that possibility, Plaintiffs
 10 funds are at risk under the plan for distribution to others. The hearing on the disclosure
 11 statement is currently set for February 20, 2008 at 10:00 a.m. The possibility that the
 12 relationships between the Plaintiffs, the Debtor and the funds which Debtor is holding
 13 for the beneficial use of Plaintiffs is sufficient to support a finding of irremedial harm, as
 14 once the funds are gone, Plaintiffs have no further remedy.

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19 **III.**

20 **CONCLUSION**

21 Plaintiffs have requested the least restrictive possible restraining order: an order
 22 restricting use of the funds which are held in trust, until such time as the clearing process
 23 is complete, and the funds paid out. Plaintiffs' require this restraint on Debtor in order to
 24 prevent Debtor from utilizing the trust funds to fund its plan and thus rendering them
 25 unavailable for their beneficial purpose. Debtor has filed its plan of reorganization two
 26 weeks ago, and has set the hearing on the disclosure statement for February 20, 2008. In
 27

1 light of the short period of time prior to the potential date for plan confirmation,
2 Plaintiffs risk their trust funds becoming unavailable for their beneficial purpose and
3 losing control of the funds to the other creditors of Debtor's estate.

5 Plaintiff respectfully request this Court grant this request for temporary restraining
6 order.

8 Respectfully Submitted,
9

10 DIEMER, WHITMAN & CARDOSI, LLP
11

12 By: /Katie Diemer/

13 Kathryn S. Diemer

14 Attorney for Plaintiffs Enhanced Long Distance,
15 Residential Voice Mail, Optimum Voice
16 Mail, Nationwide Voice Mail, United Voice
17 Messaging, and Nationwide Voice Messaging